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No. 675

In the Supreme Court of the United States

OCTOBER TERM, 1970

COMMERCIAL SOLVENTS CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINION BELOW

The opinion of the Court of Claims (Pet. 4a–49a) is reported at 427 F. 2d 749.

JURISDICTION

The judgment of the Court of Claims was entered on June 12, 1970 (Pet. 4a, 49a). The petition for a writ of certiorari was filed on September 10, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTIONS PRESENTED

1. Whether the Court of Claims correctly held that petitioner may not claim a tax refund on one issue in

this case because its position is based on grounds not advanced in its refund claim to the Internal Revenue Service and the Service had no cause to believe that petitioner would take a position inconsistent with that maintained throughout all administrative proceedings.

2. Whether the court below correctly held that certain payments which petitioner received in consideration of its cancellation of a contract constituted ordinary income rather than the proceeds from the sale or exchange of a capital asset.

STATUTES INVOLVED

Internal Revenue Code of 1939 (26 U.S.C. (1952 ed.)):

> SEC. 117. CAPITAL GAINS AND LOSSES.
>
> (a) *Definitions.*—As used in this chapter—
>
> (1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *.
>
> * * * * *
>
> SEC. 3772. SUITS FOR REFUND.
>
> (a) *Limitations.*—
>
> (1) *Claim.*—No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been

erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

* * * *

STATEMENT

In 1948, petitioner entered into an agreement with Mathieson Chemical Corporation (Mathieson), cancelling an executory contract executed in 1947, which had given petitioner the right to purchase most of the anhydrous ammonia output of one of Mathieson's plants. Under the terms of the cancellation agreement, Mathieson was obligated to pay petitioner $2.6 million over an eight and one-half year period, $500,000 being paid upon execution of the agreement in 1948, $300,000 being payable on July 1st of each of the six succeeding years (1949–1954), and $150,000 being payable on July 1st of each of the final two years (1955–1956). (Pet. 36a–37a.)

In its 1948 and 1949 income tax returns, petitioner reported the payments received in those years from Mathieson as ordinary income (Pet. 38a, 46a). On July 31, 1951, petitioner filed an amended 1948 income tax return in which it included as ordinary income taxable in 1948 all amounts paid or payable by Mathieson to it in the years 1948–1956 (Pet. 38a). A few

days later, petitioner filed a claim for refund of 1949 taxes based on the contention that it had erroneously included in 1949 income the $300,000 received from Mathieson on July 1, 1949, petitioner claiming that such sum was instead properly includible in its 1948 income (Pet. 46a). In filing its income tax returns for 1950–1956, petitioner did not include in its income any portion of the payments received from Mathieson in those years, either as ordinary income or as long-term capital gain (Pet. 47a). On June 30, 1954, petitioner filed a timely claim for refund of 1948 taxes, contending that the entire amount of $2.6 million received and receivable from Mathieson was not ordinary income, but constituted long-term capital gain representing the proceeds from the sale of a capital asset held for more than six months. This refund claim was rejected on December 18, 1961. (Pet. 39a–41a.)

As a result of the audit of petitioner's tax returns for 1951 and 1954–1956, the Commissioner of Internal Revenue determined deficiencies in income tax for each of these years, causing petitioner to file petitions in the Tax Court on July 5, 1960, and May 11, 1962, contesting the proposed increase in its tax liabilities. The issues presented in the Tax Court actions were in no way related to the transactions involved in this case (Pet. 47a). While the Tax Court cases were pending, petitioner filed its petition with the Court of Claims on December 13, 1963, asserting as its sole ground for recovery of 1948 taxes (par. 10) "that the amount of $2,600,000 receivable from Mathieson Chemical Corporation was not ordinary income but represented the

proceeds from the sale of a capital asset." On May 14, 1965, while petitioner's appeal from the Tax Court decisions was still pending, the parties settled such cases and dismissed the actions. By virtue of the dismissal, no further deficiencies in petitioner's income taxes for 1951 and 1954–1956 could be asserted by the Internal Revenue Service.

In its amended petition filed with the Court of Claims on September 13, 1965, petitioner added second and third causes of action (pars. 18–20, 22), reversing the position it had taken since 1951 by asserting that only the initial $500,000 payment which it received from Mathieson was properly includible in its 1948 income, thereby entitling it to an alleged additional refund in the amount of $525,000. Prior to the time that the amended petition was filed, petitioner's officers, employees, and representatives had made no statements or representations to the Internal Revenue Service indicating that petitioner intended to or did in fact claim a refund of 1948 income taxes on the grounds set forth in the second and third causes of action of its amended petition (Pet. 48a–49a). When the parties settled and dismissed the Tax Court cases for 1951 and 1954–1956, neither the Department of Justice nor the Internal Revenue Service knew that petitioner would thereafter amend its petition in the instant action to allege that the sums due from Mathieson were taxable in the years actually received rather than in 1948.

In dismissing petitioner's petition and amended petition, the Court of Claims held that petitioner had

"failed in the administrative stage to claim a refund on a ground which raised the accrual issue, and thereby failed to properly put the Service on notice of its intention to advance such ground in a judicial forum." (Pet. 15a). The court further concluded that petitioner's contract right to purchase anhydrous ammonia did not constitute a capital asset and that, accordingly, the surrender or sale of that right did not give rise to capital gain income (Pet. 16a, 22a).

ARGUMENT

The decision below is correct. There is no conflict of decisions or any other basis for further review by this Court.

1. Section 3772(a)(1) of the Internal Revenue Code of 1939, *supra*, pp. 2–3, states that no refund suit may be maintained unless a refund claim has been filed in accordance with Treasury Department regulations. Treasury Regulations 111 (1939 Code), Section 29.322–3, provides, in pertinent part, that "The claim must set forth in detail each ground upon which a refund is claimed * * *." It is well-settled, therefore, that a taxpayer may not present one ground for refund in its claim and a different ground in its petition; nor may it impose upon the Internal Revenue Service the burden of deducing from a known fact situation all potential legal grounds which might be advanced in support of a refund. *Angelus Milling Co.* v. *Commissioner*, 325 U.S. 293, 297–298; *United States* v. *Felt & Tarrant Co.*, 283 U.S. 269; *Real Estate Title Co.* v. *United States*, 309 U.S. 13, 17–18;

Union Pacific Railroad Co. v. *United States*, 401 F. 2d 778 (Ct. Cl.).

2. Petitioner's reliance (Pet. 4) on *St. Joseph Lead Co.* v. *United States*, 299 F. 2d 348 (C.A. 2), is misplaced. In that case, the Internal Revenue Service discovered that the taxpayer was entitled to a larger refund than that requested, due to accounting errors in the original return which were not particularized in the refund claim. In view of the nature of the adjustments, and the fact that the taxpayer would naturally wish to take advantage of such favorable adjustments to which it was otherwise entitled, the Second Circuit held that (299 F. 2d at 351), "the Commissioner 'in determining the merits of the original claim' would necessarily have ascertained 'the facts on which the amendment is based,'" and that, in such circumstances, "It was sufficient to place the Commissioner on notice of these facts and for these reasons the amended claim relates back to the time the original claim was filed * * *."

In contrast, the Court of Claims found in the instant case that (Pet. 13a)—

> * * * at no time during the entire administrative proceedings did the Internal Revenue Service have cause to believe that plaintiff claimed, or would claim, an additional refund of 1948 income tax based upon the alleged impropriety of taxing the entire gain in 1948. Indeed, it was plaintiff who requested such treatment, to which request the Service acceded. And it was not until the addition of the second and third causes of action in the 1965 amended

> petition that the Service was first put on notice *by plaintiff* of its claim that, contrary to its earlier requested treatment, the gain was not reportable in its entirety in 1948. * * *

Unlike the *St. Joseph Lead Co.* situation, the government would be severely prejudiced here if petitioner could now add these grounds to its original claim, for petitioner's delay in providing notification has caused the government to allow the closing of those tax years directly affected by petitioner's new and revised position.[1]

3. The decision below on the capital gains issue is no more than another addition to a long line of cases which have held that contract rights to purchase inventory or stock in trade are not capital assets. *Coleman* v. *United States*, 388 F. 2d 337 (Ct. Cl.); *Appalachian Electric Power Co.* v. *United States*, 158 F. Supp. 138 (Ct. Cl.); *Commissioner* v. *Pittston Co.*, 252 F. 2d 344 (C.A. 2), certiorari denied, 357 U.S. 919; *Leh* v. *Commissioner*, 260 F. 2d 489 (C.A. 9). As a result, any gain realized on the sale or surrender of such rights constitutes ordinary income. The rationale for this rule is aptly stated in the *Appalachian* decision, wherein the Court of Claims observed that (p. 141)—

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[1] Moreover, even if petitioner had timely raised the accrual issue, recognized accounting principles support the conclusion that the full amount payable under the Mathieson contract was properly includible in petitioner's 1948 income. *Universal Oil Products Co.* v. *Campbell*, 181 F. 2d 451 (C.A. 7), certiorari denied, 340 U.S. 850, rehearing denied, 340 U.S. 894; *Washington Post Co.* v. *United States*, 405 F. 2d 1279 (Ct. Cl.).

> * * * the cancellation, in consideration of a payment of money, * * * of a contract out of which one or the other of the parties hopes to make a profit, which, if he performed the contract and made the profit, would be taxable income, would seem to result in the earlier receipt of a part of the anticipated profit, with similar tax consequences.

4. The result reached by the court below is fully consistent with the decisions in *Commissioner* v. *Ferrer*, 304 F. 2d 125 (C.A. 2), and *Hollywood Baseball Assn.* v. *Commissioner*, 42 T.C. 234, affirmed, 352 F. 2d 350 (C.A. 9), vacated and remanded on another issue, 383 U.S. 824. Indeed, the Court of Claims in its opinion discussed in *Ferrer* decision at length (Pet. 16a–19a) and relied in part upon its reasoning (Pet. 22a). Petitioner's contention (Pet. 7) that it held a "proprietary interest in Mathieson's plant * * * as great as Ferrer's proprietary interest in the play" is incorrect. In *Ferrer* the court held that the taxpayer's lease was similar to interests recognized in decided cases to be (304 F. 2d at 130, 131) "something more than an opportunity, afforded by contract to obtain periodic receipts of income, by dealing with another." Here, on the other hand, there was no recognized estate or interest, but only an opportunity to obtain periodic receipts of income from a contract to purchase future production. As the Court of Claims observed (Pet. 19a), therefore, to whatever extent petitioner might have been able to obtain specific performance of its contract, the availability of this

equitable *remedy* was not attributable to any proprietary or equitable *interest* which petitioner held in Mathieson's plant, but was simply because of the difficulty of computing damages.

Hollywood Baseball Assn. likewise in inapposite. In that case, the Ninth Circuit held that a baseball team's monopoly to operate within a specific geographic area, including the exclusive right to sell admissions, concessions, advertising, and television and broadcasting privileges in the locale, constituted a going business and, as such, was property. In contrast, petitioner's rights represented nothing more than "a naked contract right" to purchase anhydrous ammonia for resale as a means of obtaining periodic receipts of ordinary income, and did not vest in petitioner any proprietary interest in the underlying capital assets. *Coleman* v. *United States, supra,* p. 333; *Commissioner* v. *Ferrer, supra,* pp. 130–131.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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